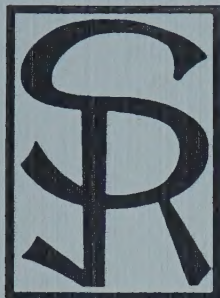


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**SOUTHWARD
RESOURCES LTD.**

**1985 ANNUAL REPORT
AUGUST 31st**



SOUTHWARD
RESOURCES LTD.

Winspear Business Library
1-18 Business Building
Edmonton, Alta. T6G 2R6

PRESIDENT'S REMARKS

To The Shareholders:

As president of your Company, I am pleased to present the fourth annual report of Southward Resources Ltd.

In reviewing last years' report, I would draw your attention to remarks that I made in summary; "We will work towards exploiting our new found reserves to the full extent in order that the profitability of the Company be realized at the earliest possible time."

I am happy to announce that our profitability was realized in the first quarter after the year end, August 31, 1985, for which this report is written. We have enclosed a copy of the first quarter results with this report and I ask the reader to consider both reporting documents to appreciate the true position of the Company at this time.

EXPLORATION

United States

Southward Resources Inc., a wholly owned subsidiary of Southward Resources Ltd., owns various working interests in six producing oil wells in the state of Utah. Nominal revenue is received due to our small working interests. High capital costs and extremely high operating costs have categorized this asset as a candidate for no further exploration activity and possible sale. Currently the Company is waiting for an offer to purchase from an interested U.S. buyer. If a sale is concluded, information of the details will be offered in the following reporting period.



SOUTHWARD
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Canada

Alberta -

No active exploration was conducted in our home province last year. Due to a continuing soft natural gas market, the Company did not pursue the tying in of two of our shut in gas wells at Chauvin and Shekilie. Currently engineering feasibility studies are being done on each property to prepare for the time when gas contracts and prices allow these reserves to be produced.

The Company anticipates a renewed exploration program will be conducted in Alberta over the succeeding months and years. The positive political setting with lower royalty structure in Alberta has required your Company to reassess the economics of the more expensive and more gas prone area's of Alberta relative to our Saskatchewan oil projects.

Saskatchewan -

During the year the Company was involved in the drilling of ten wells. Of these, four were completed as producing oil wells and six were dry and abandoned. Although this success ratio is not outstanding, subsequent drilling after year end of a further eight wells produced seven oil wells and one dry hole. Considering the above information, the overall drilling results show 11 oil wells and 7 abandonments for a 60% success ratio over 17 months.

More importantly, the productivity of our average successful well is far greater than the industry average. Daily oil production on several of our Willmar wells is over 100 barrels of oil per day, each.

The Company anticipates a more modest exploration program in Saskatchewan in 1986.



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FINANCIAL

As shown by the following auditor's report, the Company spent over \$474,000 on capital acquisitions during the year. Of this amount \$329,000 was related to drilling costs. These expenditures led directly to a five fold increase in net proven oil reserves while production revenue increased 50% relative to 1984. The substantial impact of increased oil sales can only be fully appreciated with a review of the 1986, fiscal first quarter financial position.

During the year \$45,000 was raised by selling 112,500 flow through shares. Subsequent to the year end a further 62,500 flow through shares were sold for \$25,000. The Company does not anticipate any further equity financings for the balance of the year.

With the current and projected rate of cash flow, Southward should be debt free by mid 1986.

SUMMARY

As shown in the accompanying quarterly report, your Company has entered a new era of profitability. I therefore take this opportunity to thank all those shareholders, staff and directors who helped make this possible. We shall endeavor to continue the excellent results in succeeding quarters.

Special thanks to Mr. Garth McTavish for his support and counsel as he leaves his position on the Board of Directors.



SOUTHWARD
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I extend a warm welcome to Scott Kiser, a Bachelor of Commerce graduate of the University of Alberta, as he joins our staff as comptroller. Scott previously worked for Gulf Canada Resources in various accounting positions.

Although the short term future of the oil and gas business may be clouded with the possibilities of lower oil and gas prices, the management of Southward firmly believes that the long term future for the Company looks very bright.

With that outlook in mind, the Company directors and staff are planning ambitious but prudent projects for the coming year.

Respectfully submitted on

Behalf of the Board of Directors

R.W. Kiser

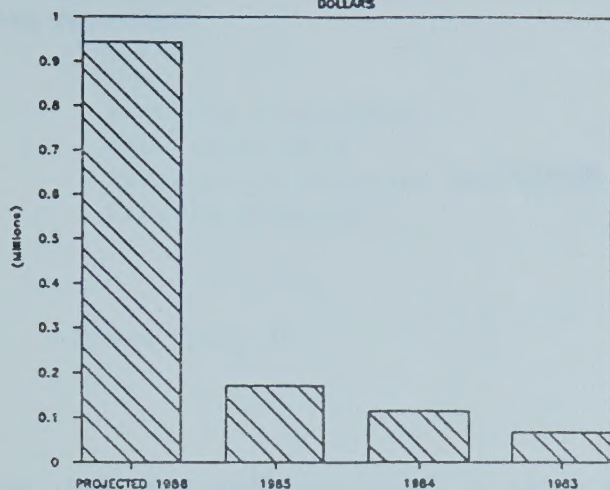
President



**SOUTHWARD
RESOURCES LTD.**

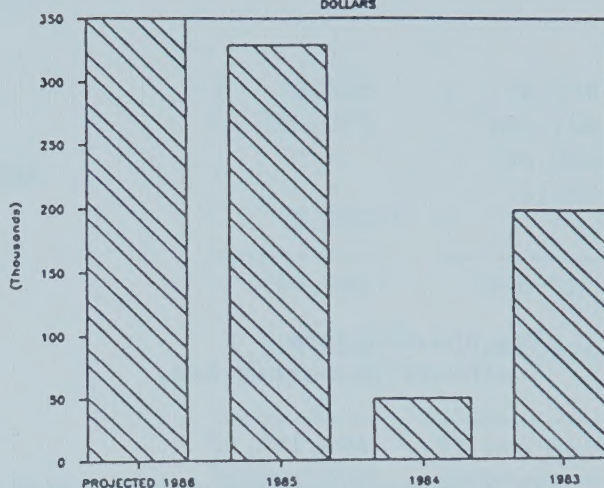
PRODUCTION REVENUE

DOLLARS



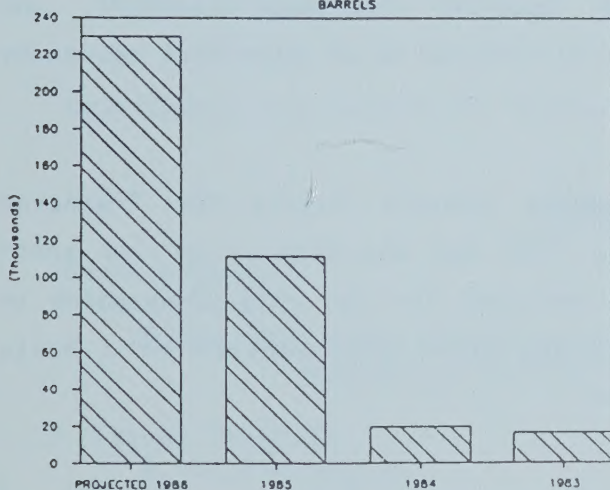
EXPLORATION & DEVELOPMENT DRILLING

DOLLARS



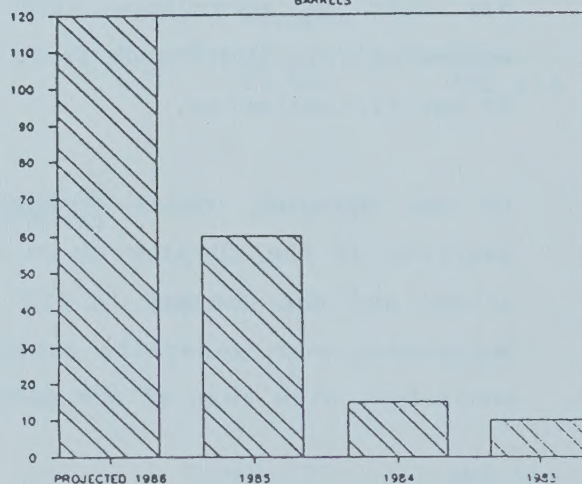
PROVEN OIL RESERVES AFTER ROYALTY

BARRELS



DAILY OIL PRODUCTION

BARRELS



**THREE YEAR COMPARISON
WITH PROJECTIONS**

	<u>Projected</u>	<u>1985</u>	<u>1984</u>	<u>1983</u>
Production Revenues	\$ 943,000	\$ 182,605	\$ 114,177	\$ 67,574
Exploration & Development Drilling	350,000	329,543	49,310	198,217
Proven Oil Reserves After Royalty	230,000	111,545	19,726	16,432
Net Daily Oil Production	120	60	15	10

R.W. St. Louis, C.A.
J.J. Geib, C.A.*

501, 1011 First Street S.W.
Calgary, Alberta T2R 1J2
Telephone: (403) 234-9284

AUDITOR'S REPORT

The Shareholders
Southward Resources Ltd.

We have examined the consolidated balance sheet of Southward Resources Ltd. as at August 31, 1985 and the consolidated statements of operations and deficit and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these financial statements present fairly the financial position of the company as at August 31, 1985 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Calgary, Alberta
January 3, 1986

St Louis Geib

Chartered Accountants

Southward Resources Ltd.
Consolidated Balance Sheet
As at August 31, 1985

	<u>1985</u>	<u>1984</u>
<u>ASSETS</u>		
Current		
Cash	\$ 39,260	\$ 134,774
Accounts receivable	206,097	260,754
Note receivable	-	46,000
Advances to officers and affiliates	-	5,000
Prepaid expenses	2,704	-
	<u>248,061</u>	<u>446,528</u>
Fixed (Note 2)	1,123,435	1,048,316
	<u><u>\$1,371,496</u></u>	<u><u>\$1,494,844</u></u>
<u>LIABILITIES</u>		
Current		
Accounts payable and accrued liabilities	\$ 519,457	\$ 492,152
Deferred (Note 8)	20,000	-
	<u>539,457</u>	<u>492,152</u>
Contingency and commitment (Notes 4 and 5)		
<u>SHAREHOLDERS' EQUITY</u>		
Share capital		
Authorized		
20,000,000 common shares without nominal or par value		
Issued (Note 9)		
6,600,004 shares	1,349,110	1,349,110
To be issued (Note 8)		
112,500 shares	25,000	-
Deficit	(585,576)	(369,734)
Cumulative translation gain	43,505	23,316
	<u>832,039</u>	<u>1,002,692</u>
	<u><u>\$1,371,496</u></u>	<u><u>\$1,494,844</u></u>

ON BEHALF OF THE BOARD:

B. W. Lister Director
Clay Ham Director

St. Louis, Cfeib

Southward Resources Ltd.
Consolidated Statement of Operations and Deficit
For the year ended August 31, 1985

	<u>1985</u>	<u>1984</u>
Revenue		
Operators fees	\$ 12,631	\$116,874
Production	182,605	114,177
Interest earned	2,402	14,733
	197,638	245,784
Direct expenses		
Operating	29,351	38,874
Depletion and depreciation	68,689	56,128
	98,040	95,002
Revenue from operations	99,598	150,782
Other expenses		
Exploration and non productive drilling	193,384	5,483
General and administrative	121,738	105,830
Interest and bank charges	318	6,838
	315,440	118,151
Operating income (loss) before undernoted item	(215,842)	32,631
Write down in carrying value of petroleum and natural gas properties (Note 2)	-	135,014
Loss for the year	215,842	102,383
Deficit, beginning of year	369,734	267,351
Deficit, end of year	\$585,576	\$369,734
Net loss per share	\$.033	\$.016

Southward Resources Ltd.
Consolidated Statement of Changes in Financial Position
For the year ended August 31, 1985

	<u>1985</u>	<u>1984</u>
Operating activities		
Loss for the year	\$(215,842)	\$(102,383)
Charges (credits) to income not requiring cash		
Effect of exchange rate changes on working capital	20,189	7,082
Depreciation and depletion	68,689	56,128
Exploration and non productive drilling	193,384	5,483
Write down in carrying value of petroleum and natural gas properties	-	135,014
	66,420	101,324
Net change in non-cash working capital balances related to operations	130,258	89,696
	196,678	191,020
Financing activities		
Proceeds of flow through shares (Note 8)	45,000	-
	45,000	-
Investing activities		
Acquisition of fixed assets	(474,025)	(98,932)
Petroleum Incentive Program Grants	111,833	13,569
Proceeds on sale of petroleum and natural gas properties	25,000	26,995
	(337,192)	(58,368)
Changes in cash during the year	(95,514)	132,652
Cash at beginning of year	134,774	2,122
Cash at end of year	<u>\$ 39,260</u>	<u>\$134,774</u>

Southward Resources Ltd.
Notes to the Consolidated Financial Statements
August 31, 1985

1. Accounting Policies

a) Consolidation

The consolidated financial statements include the accounts of the company and its wholly-owned subsidiary, Southward Resources Inc.

b) Oil and gas expenditures

The company follows the successful efforts method of accounting, wherein costs of exploring for and development of oil and gas reserves are capitalized. These costs include lease acquisition costs, geological and geophysical expenses and the cost of drilling productive wells. Dry holes and abandoned projects are written off when determined to be unproductive. Costs capitalized are depleted on the unit of production method based on estimated proven recoverable oil and gas reserves.

Grants receivable under Petroleum Incentives Program are accrued in the accounts at the time qualifying expenditures are made.

c) Depreciation

Furniture and fixtures are depreciated on a 20% declining balance basis and automotive equipment is depreciated on a 30% declining balance basis.

d) Foreign currency translation

The company translates the accounts of the U.S. subsidiary to Canadian dollars by translating the balance sheet at the rate in effect at the year-end date. The statement of operations is translated at the average rate for the year. The effect of the translation is included in shareholders' equity.

2. Fixed, at cost

	<u>1985</u>	<u>1984</u>
Petroleum and natural gas properties	\$1,261,791	\$1,126,011
Furniture and fixtures	3,864	2,785
Automotive	4,300	
	<u>1,269,955</u>	<u>1,128,796</u>
Less accumulated depletion and depreciation	146,520	80,480
	<u><u>\$1,123,435</u></u>	<u><u>\$1,048,316</u></u>

The carrying value of the petroleum and natural gas properties was reduced during fiscal year end 1984 by \$135,014 to reflect the adjusted value of the underlying oil and gas reserves. The write down was calculated using the value of the company's proven oil and gas reserves as estimated by an independent engineering consultant using unescalated prices discounted at 10%.

Southward Resources Ltd.
Notes to the Consolidated Financial Statements (Cont.)
August 31, 1985

3. Remuneration

Remuneration paid to officers and/or directors of the company amounted to \$54,000 (1984 - \$64,500) for the year.

4. Contingency

The company is a defendant in an action arising from the fiscal 1985 drilling of certain oil and gas properties which were placed on production during the year. The plaintiff's allege to hold an interest in the respective properties. The company is not able to estimate the effect, if any, on earnings which would result from settlement in the plaintiff's favour or on the resultant carrying value of the company's investment.

5. Commitment

The company has entered into a lease agreement, terminating in 1987, for office space at an annual rental of:

1986	\$16,440
1987	\$16,440

6. Segmented Information

The company conducts its petroleum and natural gas activities in Canada and the United States.

	1985		
	<u>Canada</u>	<u>United States</u>	<u>Consolidated</u>
Net loss	\$207,169	\$ 8,673	\$ 215,842
Identifiable assets	\$987,518	\$383,978	\$1,371,496
Capital expenditures	\$474,025	\$ -	\$ 474,025
	1984		
	<u>Canada</u>	<u>United States</u>	<u>Consolidated</u>
Net loss	\$ 14,365	\$ 88,018	\$ 102,382
Identifiable assets	\$1,057,770	\$437,074	\$1,494,844
Capital expenditures	\$ 98,932	\$ -	\$ 98,932

Southward Resources Ltd.
Notes to the Consolidated Financial Statements (Cont.)
August 31, 1985

7. Predecessor Auditors

The 1984 consolidated financial statements were examined by other auditors whose report dated November 19, 1984 expressed an unqualified opinion. Certain 1984 amounts have been restated to conform with current presentation.

8. Flow Through Shares

The company has entered into a flow through share subscription agreement whereby 112,500 shares will be issued upon completion of certain drilling expenditures. The proceeds received as consideration for this agreement were \$45,000. Because the subscriber will be receiving the deduction of certain drilling expenditures for income tax purposes, the amount credited to share capital has been adjusted for the estimated income tax benefits to be flowed out to the subscriber. The balance has been credited to deferred liability. The shares were issued from treasury on December 10, 1985.

9. Share Capital

In exchange for the guaranteeing of certain future company bank debt by a related corporation the company has issued an option to the related corporation to purchase 50,000 common shares at a price of \$.20 per share. The option expires August 6, 1986, unless the guarantee is still in effect. Should the guarantee continue then the option will be automatically extended one year.

10 Income Taxes

As at August 31, 1985 the company had losses for income tax purposes in the amount of \$154,594 which are available to reduce future years' income taxes. The losses and their respective year of expiry are as follows:

1989	\$116,247
1990	23,984
1991	14,363
	\$154,594

SOUTHWARD RESOURCES LTD.
CORPORATE INFORMATION

OFFICERS

Richard Wayne Kiser
President

DIRECTORS

Richard Wayne Kiser
Clayton G. Harmon
Garth McTavish

HEAD OFFICE

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T2R 1K4

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Chartered Accountants
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Calgary, Alberta
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Barristers & Solicitors
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Calgary, Alberta
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Calgary, Alberta
T2P 3C5

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T2R 0Y4

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Calgary, Alberta
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TRADING SYMBOL

SWD

